



Senate Republican Office of Policy

Briefing Report

Federal Tax Conformity and Pension Plans

January 30, 2002

Background

California conforms to federal income tax law in many areas. Doing so avoids confusion, harmonizes and makes federal and state tax impacts more predictable, eases taxpayers' preparation of tax returns, and facilitates compliance enforcement. California regularly enacts "date conformity" to harmonize California tax law with federal tax law as of a certain date and makes other substantive conforming changes that cannot be accommodated via date conformity.

California has not enacted an omnibus conformity bill since AB 2797 (Cardoza, 1998). Accordingly, California conforms to the federal Internal Revenue Code [IRC] as of January 1, 1998 and incorporates none of the subsequent IRC changes. Last year, the federal Economic Growth and Tax Relief Reconciliation Act of 2001 [EGTRRA] was signed into law. It provides rebates to taxpayers, reduces some tax rates, increases contribution limits for all types of Individual Retirement Accounts [IRAs], defined benefit plans including PERS, 401(k), 403(b), 457, and qualified tuition plans. EGTRRA also allows those over age 50 who've lagged behind in saving for retirement to accelerate contributions to their pension plans. In short, EGTRRA is the best thing to happen to pension and retirement account taxation in over a decade.

The Problem

If California does not act to conform to EGTRRA, state taxpayers will not enjoy the benefits of the increased retirement account savings. This should be encouraged as a matter of policy. Also, individuals and employers alike will be confused about the applicable limits for these accounts and the related withholdings allowable.

Worse still, if Californians contribute at the higher federal limits, their retirement plans could become disqualified for tax-deferred treatment by the State and all income in those accounts could be subject to State income taxes and possible penalties. And Californians who comply with the different state and federal contribution limits will have

to maintain two separate sets of financial records to comply with the federal and State tax requirements

The Solution

Individuals should be encouraged to plan and save for both retirement and education by having the full availability of EGTRRA limits at both federal and State levels. Several pieces of actual or planned legislation to accomplish this conformity are in process.

◆ SB 657 (Scott)

SB 657 (Scott) would provide complete conformity with EGTRRA for education savings, pension plans, and retirement accounts. A comparison of EGTRRA, State law, and SB 657 provisions is shown in the chart below.

Conformity Comparison: EGTRRA; State law; SB 657

Item	EGTRRA	State Law	SB 657
Traditional IRA contributions	Increased from \$2000 to \$3000 in 02-04, increasing to \$5000 in 08 and \$500 annually thereafter	\$2000	\$3000, follows feds
Educational IRA contributions	> Increased from \$500 to \$2000 > Permits corporate contributions	\$500 No corporate contributions	\$2000 Corporate contributions too
Roth IRA contributions	Increased from \$2000 to \$3000 in 02-04, increasing to \$5000 in 08 and \$500 annually thereafter	\$2000	\$3000, follows feds
401(k) Plan	\$11,000 going to \$15,000 in '06 and indexed thereafter	\$10,500	\$11,000 follows feds
403(b) Plan	\$11,000 going to \$15,000 in '06 and indexed thereafter	\$10,500	\$11,000 follows feds
457 Plan	\$11,000 going to \$15,000 in '06 and indexed thereafter	\$8,500	\$11,000 follows feds
401(k) - 457 coordination	\$11,000 in each one	\$10,500 limit in total	\$11,000 in each one
Over 50 catch-up	\$500 extra for 02-05 \$1000 in 06 and after	No	Same as feds
Portability	> Rollovers among 457, 403(b) and qualified plans > Rollover of IRAs to workplace plans	No extensive rollovers	Rollovers as per feds

	> Rollover of after-tax plan contributions		
Defined contribution plans, PERS	Increases contributions to \$40,000 with indexing in \$1000 amounts	\$35,000 limit	\$40,000 follows feds
Defined benefit limit, e.g., PERS, STRS	Increases from \$140,000 to \$160,000	\$140,000	\$160,000 follows feds
Retirement/SocSec	Early retirement at 62 Lowers normal retirement to 65	Retirement age set per Social Security	Early at 62 Normal at 65 per feds

- Fiscal effect: The Franchise Tax Board estimates SB 657 will reduce revenues as follows [shown in millions]:

Year	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11
Effect	-\$44	-\$48	-\$59	-\$121	-\$135	-\$173	-\$193	-\$207	-\$166

- Status: SB 657 passed the Senate Revenue and Taxation Committee 5-0 (AYES: Poochigian and Knight) and is set for hearing in the Senate Appropriations Committee on 1/24/02.

◆ Additional Legislation

Senators Brulte and Poochigian, and Assembly Member John Campbell plan to introduce similar legislation.

◆ Partial Conformity

If budgetary pressures require it, partial conformity will be considered, including the possible deferral of the State tax benefits without disqualifying plans for contributions at federal EGTRRA levels.